

TAXATION – BLOCK REVISION MOCK 16

QUESTION ONE

- (a) Differentiate between the low interest benefit tax and the fringe benefits tax.
(4 marks)
- (b) with reference to the provisions of the Income Tax Act, identify four methods which the Commissioner of Income Tax is empowered to use in order to collect overdue tax from a taxpayer.
(4 marks)
- (c) With the introduction of the self-assessment system in 1992, the Commissioner of Income Tax does not raise assessments or send notices to taxpayers except in two circumstances.
Explain these two circumstances.
(4 marks)
- (d) List six matters that are contained in a notice of assessment.
(6 marks)
- (e) What is “stamp duty”?
(2 marks)

(Total: 20 marks)

QUESTION TWO

Mobile Options Ltd. is a distributor of mobile phones and accessories. The profit and loss account for the year ended 31 December 2005 is as follows:

	Sh.		Sh.
Purchases	12,000,000	Sales	18,000,000
Salaries and wages	2,000,000	Discounts	400,000
Rent and rates	125,000	Insurance recovery	180,000
Distribution and office expenses	480,000	Profit on sale of assets	240,000
Traveling and subsistence	336,000	Provision for bad debts	80,000
Subscriptions	50,000		
Licences and permits	200,000		
Legal fees	436,000		
Depreciation	670,000		
Audit fees	130,000		
Loss on sale of assets	240,000		
	96,000		

Bank charges and interest	415,000	
Bad debts	336,000	
Discounts	705,000	
Repairs and maintenance	<u>681,000</u>	
Net profit	<u>18,900,000</u>	<u>18,900,000</u>

Notes:

1. Distribution and office expenses include the following:

Sh.

Subscriptions to Wananchi sports Club for employees' benefit	180,000
Directors' personal expenses	96,000
Donations to charity	50,000

2. 15% of rent and rates relate to payments in connection with directors' private residences.

3. Insurance recovery is in connection with mobile phones stolen while on transit to a client.

4. Bad debts provision represents a reduction in the general provision for bad debts.

5. Legal fees include the following:

Sh.

Debt collection	80,000
Employment contracts	60,000
Acquisition of trade mark	120,000
Renewal of lease – 50 years	60,000
Legal suit in relation to counterfeit	
Handsets found in the company's warehouse	<u>116,000</u>
	<u>436,000</u>

6. Subscriptions are to the Mobile Phone Dealers Association.

7. Licences and permits represents sh.150,000 paid to the Communications Commission of Kenya (CCK) and Sh.50,000 relates to the single business permit paid to the Nairobi city Council.

8. Repairs and maintenance include an extension to the warehouse at a cost of Sh.450,000.

9. Travelling expenses include sh.240,000 incurred by the sales manager when he traveled to South Africa to attend a mobile phones and accessories trade fair.

10. Capital allowances have been agreed with the Commissioner of Income Tax at Sh.860,000.

Required:

(a) Compute Mobile Options Ltd.'s taxable profit or loss for the year ended 31 December 2005.

(12 marks)

(b) Compute the tax payable thereon.
marks)

(2

(c) Assuming that Mobile Options Ltd.'s tax liability for the year ended 31 December 2004 was sh.800,000, indicate the due dates for the tax you have computed in (b) above showing the amounts payable.

(4 marks)

(d) Compute the penalties payable by Mobile Options Ltd. if the company paid the tax of Sh.800,000 in (c) above on 30 November 2005.

(2 marks)

(Total: 20 marks)

QUESTION THREE

(a) Mr. Hassan Ali's contract of employment with Kenwide Ltd. which was to run for five years was terminated on 31 December 2005 after the contract had run for three years. A compensation of sh.960,000 which had been stipulated in his contract was paid. His salary, as at the date of termination was sh.30,000 per month.

Required:

(i) Compute the income assessable on Mr. Hassan ali and indicate the year(s) to which the income relates.

(2 marks)

(ii) Assuming that Mr. Hassan Ali's contract did not provide for payment of compensation nor the contract period, what income would be assessable on him and in which years?

(2 marks)

(iii) Compute the tax payable by Mr. Hassan Ali in (i) above.

(4 marks)

(iv) When is the tax you have computed in (iii) above payable?

(2 marks)

(b) (i) Recently Kusoma Institute underwent a PAYE audit by the Kenya Revenue Authority

(KRA) auditors after which penalties amounting to sh.1,000,000 were levied.

Explain the circumstances that might have triggered the PAYE audit at Kusoma Institute.

(5 marks)

(ii) The income of educational institutions is exempt from tax. What would be the tax implications of a proposal to pay school fees for the children of junior staff who qualify for university admission?

(2 marks)

(iii) List three “unique” disallowable expenses against partnership income.

(3 marks)

(Total: 20 marks)

QUESTION FOUR

You are provided with the following information concerning Bimak Ltd., a company that makes its accounts to 31 December every year.

The company bought an industrial building from Mr. Kujenga at a cost of Sh.20,000,000 in 2002. Mr. Kujenga had constructed the building in 2001 at a cost of Sh.16,600,000 which included the cost of land amounting to Sh.4,000,000, a canteen for workers for Sh.2,400,000, showroom costing Sh.600,000 and offices costing Sh.1,500,000. The building however, had not been put into any use in 2002.

In the same year, Bimak Ltd. made the following additions to the building:

A warehouse at a cost of Sh.3,600,000

Labour quarters costing sh.2,400,000

Extension to the factory building to accommodate machines at a cost of Sh.4,200,000.

Before commencing manufacturing on 1 July 2003, Bimak Ltd. acquired the following additional assets:

Processing machinery	-	Sh.5,200,000
Labour Cruiser	-	Sh.1,200,000
A three ton lorry	-	Sh.2,600,000
A tractor	-	Sh.3,600,000
Furniture and fittings	-	Sh.1,200,000

Bimak Ltd. converted one of the director's Mercedes Benz vehicles into company's use. It was valued at Sh.1,500,000 and was used entirely for the company's business.

Computers	-	Sh.1,600,000
Photocopier	-	Sh. 240,000
Saloon car	-	Sh.1,200,000

In the year 2004, Bimak Ltd continued expanding and acquired/constructed the following:

Additional processing machinery - Sh.2,400,000

An additional factory extension was constructed at a cost of sh.4,600,000 which included an administrative office costing Sh.1,000,000. These were brought into use with effect from 1 September 2004.

A fire exit was also constructed at a cost of Sh.900,000 and brought into use on 1 July 2004.

The management disposed of the following assets in the year 2000:

Processing machinery Sh.1,200,000

One of the computers purchased in 2003 for sh.120,000 was traded in with another one valued at Sh.300,000. The trade-in-value was sh.150,000.

The Mercedes Benz was disposed of at Sh.600,000.

In the year 2005, Bimak Ltd. decided to strengthen the security at the factory by building a stone perimeter fence at a cost of Sh.1,800,000. This was brought into use with effect from 1 June 2005. The company bought a Range Rover for the Chief Executive at a cost of Sh.2,400,000.

Required:

(a) Bimak Ltd.'s capital allowances for each of the years ended 31 December 2003, 2004 and 2005.

(16 marks)

(b) Obtain the written down values of the assets as at 31 December 2001.
(4 marks)

(Total: 20 marks)

QUESTION FIVE

(a) With reference to the tax legislation in your country, write brief notes on the following:

- (i) Import declaration form. (3 marks)
- (ii) Reverse charge. (3 marks)
- (iii) Refund of duty paid on imported goods. (3 marks)

(b) ABC Ltd imported goods from Dubai whose landed value was Sh.2,450,000. Duty is chargeable on them at the rate of 20%. Other charges include a provision for transport to the company premises amounting to Sh.110,000 and a commission of 5% of dutable value to the clearing agent. VAT was charged on the goods at the standard rate (16%).

Required:

Determine the amount of VAT payable.
(3 marks)

(c) Akuru and Associates is a firm of Certified Public Accountants. During the month of December 2005, the firm provided accountancy, audit and tax consultancy services to XYZ Ltd. and charged the following fees:

	Sh.
Accountancy	- 120,000
Audit	- 240,000
Tax consultancy	- 180,000

VAT was charged at the rate of 16%.

Required:

(i) Prepare a tax invoice as per the requirements of the VAT Act and regulations for XYZ Ltd.

(5 marks)

(ii) Prepare a VAT account for Akuru and Associates, assuming that they did not perform any other professional assignments in December 2005. However, they bought stationery worth Sh.75,520, inclusive of VAT and paid an electricity bill which included Sh.7,210 VAT. (3 marks)

(Total: 20 marks)

SUGGESTED ANSWERS

QUESTION ONE

(a) **Low interest benefit tax and the fringe benefits tax**

Low interest benefit results from the charging of a low rate of interest on an employment benefit as compared to the commissioner's prescribed marked rate of interest. The employment benefit applicable is normally staff loan(s) advanced to staff at a concessionary rate(s) of interest.

The difference between the commissioner's prescribed market rate (currently 15%) and the concessionary rate of interest charged to staff by the employer constitutes a taxable benefit for all loans given before 12 June 1998. The benefit is taxable on the employee based on the ruling PAYE rates.

Fringe benefits tax (FBT)

Fringe benefits tax is applicable to all employment benefits (loans) given to employees or their relatives on or after 12 June 1998 at concessionary rates of interest. It is based on the 91 days average treasury bill rates. The average rate is computed and issued by the Kenya Revenue Authority through the press.

The tax is payable by the employer at the average treasury bill rate less the interest rate charged to the employees. The tax is based on the ruling corporate tax rate which is currently 30%.

FBT is submitted together with PAYE before 10th of the following month together with PAYE.

(b) **Four methods the Commissioner of Income Tax is empowered to use in collecting overdue tax**

- Commissioner of Income Tax can use for the recovery of the tax through a court of law.
- Commissioner of Income Tax can collect the tax through authorized agents under Section 96
- Can collect under Section 102 by distress i.e. can seize property
- Commissioner of Income Tax under Section 103 can attach property of a tax payer as security for unpaid tax.

(c) **Three circumstances under which CIT can send notices or raise assessments:**

- A person has not submitted a return of income and the CIT considers that the person has income chargeable to tax for that years
- CIT considers that a person has been assessed or has assessed himself at a less amount in relation to income or tax payable.
- Where CIT issues an agreed amended assessment but later discovers unassessed income.

(d) **Matters that are contained in a notice of assessment**

- Notice to the taxpayer that he has been assessed under the Income Tax Act (ITA)
- Information to the taxpayer that he has a right to object to the notice of assessment
- Amount of tax assessed or loss to be carried forward
- Amount of relief available (in case of individual)
- Any amount of tax paid at source
- Personal identification number (PIN)
- Interest and penalties where applicable
- Amount of tax payable, due date, or where tax is overpaid amount of refund
- Name/and address of taxpayer

(e) **Stamp duty**

Stamp duty is charged on a large number of legal documents and agreements e.g cheques, bonds, marketable securities etc.
Payable within 30 days after transaction.

QUESTION TWO

- (a) Mobile Options Ltd.
Computation of Taxable Profit for the year ended 31 December 2005

	Sh.	Sh.
Net profit as per a/cs		681,000
Add back:		
Donations	50,000	
Director expenses	96,000	
Rent and rates	18,750	
Depreciation	670,000	

Year 2008 - Sh.240,000
- Sh.960,000

(iii)

- Rate of tax should be the last known rates in this case year 2005. For each of the 2 years, he would be taxed on Kshs. 480,000 as follows:

	Shs.
1 st Kshs. 466,704 = (121,968 @ 10%) + 114,912 @ (15% + 20% + 25%) =	81,144
Surplus (480,000 – 466,704) @ 30%	3,989
Gross tax	85,133
Less p/relief	<u>(13,944)</u>
Net tax	<u>71,189</u>

Total = 71,189 p.a. x 2 yrs = 142,372

(iv) The tax is payable together with normal PAYE (but shown separately) by 9th of January 2006.

(b) (i) **Circumstances that may trigger off a PAYE Audit**

- PAYE not paid on time
- Salaries and wages figure as per annual accounts is high compared to that reflected in PAYE returns.
- Major month to month variances on PAYE payments
- Third party information/complaints
- Newspaper/Media reports
- Non-compliance detected during a normal tax audit
- Failure to submit PAYE Returns
- Failure to keep proper records.

(ii) **Taxation of School fees**

Since Kusoma Institute is tax exempt,, school fees will be taxed on the employees concerned as a benefit.

(iii) **Unique disallowable partnership expenses**

- Remuneration/salary paid to partners
- Interest on capital paid to partners
- Drawings by partners
- Commission paid to partners

QUESTION FOUR

- (a) Bimak Ltd
Capital Deductions (using year 2004 rates)
Investment Deductions Schedule

Year	Asset	Q.Cost Sh.	I.D @ 100% Sh.	Residue Sh.
2003	Factory building	8,100,000	8,100,000	-
2003	Factory extension	4,200,000	4,200,000	-
2003	Processing machine	5,200,000	<u>5,200,000</u>	-
			<u>17,500,000</u>	
2004	Processing machine	2,400,000	2,400,000	-
2004	Factory extension	3,600,000	<u>3,600,000</u>	-
			<u>6,000,000</u>	

Industrial Building Deduction Schedule

Year	Building	Q. Cost Sh.	Bal b/d Sh.	IBD 25% Sh.	@ Bal C/d Sh.
2003	Workers canteen	2,400,000	-	30,000	2,370,000
	Warehouse	3,600,000	-	45,000	3,555,000
	Labour quarters	2,400,000	-	<u>30,000</u>	2,370,000
	NB: I.B.D for 6 months only			<u>105,000</u>	
2004	Workers canteen	2,400,000	2,370,000	60,000	2,310,000
	Warehouse	3,600,000	3,555,000	90,000	3,465,000
	Labour quarters	2,400,000	2,370,000	60,000	2,310,000
	Fire exit	900,000	-	<u>11,250</u>	888,750
	6 months IBD			<u>221,250</u>	
	Factory extension			<u>322,500</u>	

*1,080,000 x 2.5% x 9,000
3/12

Year	Building	Q. Cost Sh.	Bal b/d Sh.	IBD 25% Sh.	@	Bal C/d Sh.
2005	Workers canteen	2,400,000	2,310,000	60,000		2,250,000
	Warehouse	3,600,000	3,465,000	90,000		3,375,000
	Labour quarters	2,400,000	2,310,000	60,000		2,250,000
	Fire exit	900,000	888,750	22,500		866,250
	Security fence	1,800,000		<u>26,250</u>		1,773,750
				<u>258,750</u>		

Wear and Tear Schedule

Class	I	II	III	IV
Land cruiser	-	-	1,000,000 ^R	-
Lorry	2,600,000	-	-	-
Tractor	3,600,000	-	-	-
Furniture and fittings	-	-	-	1,200,000
M. Benz and saloon car @ Sh.1M ^R	-	-	2,000,000 ^R	-
	<u>-</u>	<u>1,840,000</u>	<u>-</u>	<u>-</u>
Computer and photocopier	6,200,000	1,840,000	3,000,000	1,200,000
	(2,325,000)	(552,000)	((150,000)
WTA for 2003	3,875,000	1,288,000	750,000)	1,050,000
WDV 1.1.2004	<u>-</u>		2,250,000	<u>-</u>
Computer	3,875,000	<u>300,000</u>	<u>-</u>	1,050,000
		1,588,000	2,250,000	
Disposals:	-			(1,200,000)
Processing machine	-	-	-	-
Computer	<u>-</u>	(150,000)	-	<u>-</u>
M. Benz	3,875,000	<u>-</u>	(400,000)	150,000
	(1,453,125)	1,438,000	1,850,000	<u>NIL</u>
WTA for year 2004	2,421,825	(431,400)	(462,500)	NIL
WDV 1.1.2005	<u>-</u>	1,006,600	1,387,500	<u>-</u>
Additions – Range rover	2,421,825	<u>-</u>	<u>1,000,000^R</u>	NIL
	(908,184)	1,006,600	2,387,500	<u>NIL</u>
WTA for year 2005	<u>1,513,641</u>	(301,800)		<u>NIL</u>
WDV 31/12/2005		<u>704,200</u>	(596,875))	

1,790,625

NB: The Shs. 150,000 in class IV is a trading receipt.

QUESTION FIVE

(a) (i) **Import declaration for**

- Import declaration form is a form supplied by the customs department for the importer to fill in order to ensure that:
- He declares/shows the goods he is importing, and that
- He indicates the correct value of the goods he is importing
- Show country of origin and destination
- Name/address of importer and exporter

(ii) **Reverse charge**

This refers to VAT charged on imported services. The VAT in this case is paid by the person importing the service since the provider of the service is outside the scope of VAT. The importer of the service also claims the tax paid as input tax.

(iii) **Refund of duty paid on imported goods**

The commissioner of customs and excise may refund duty paid on imported goods under the following circumstances:

Where goods are returned to seller

Re-assessment leads to lower duty

Where goods are lost or destroyed in an accident while under customs control

Where goods are used in production of exports or specified duty exempt goods.

(b) **Amount of VAT payable**

	Sh.
Landed value	2,450,000
Duty 20%	<u>490,000</u>
	2,940,000
VAT 16%	<u>470,400</u>

3,410,400

(c) (i) VAT Invoice

Akuru & Associates
Akuru House, 4th Floor
Waiyaki Way
P O Box 000 Nairobi

To:	ABC Ltd. P O Box 20 NAIROBI	INVOICE NO. 101 Date: 31 st December 2005 LPO No.1089		
Quantity	Description	Rate	Sh.	Cts.
1	Accountancy	120,000	120,000	00
1	services	240,000	240,000	00
1	Audit fees for 2005	180,000	180,000	00
	Tax consultancy			
	VAT @ 16%		540,000	00
			86,400	00
E&OE		Total	626,400	00
VAT REG. NO.0099888A		PIN NO. P120099978X		

(ii)

VAT A/C

	Sh.		Sh.
Input tax	18,730	Output tax	86,400
VAT payable	<u>67,670</u>		
	<u>86,400</u>		<u>86,400</u>